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Breakthroughs on Fundamental Issues of Socialist Political Economy in China's Economic Reform

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社会主义初级阶段公有制为主体、多种所有制经济共同发展的基本经济制度，与市场机制对资源配置起决定性作用，二者如何实现有效结合，这是构建中国特色社会主义政治经济学的根本性难题。西方资产阶级经济学以及对马克思主义经典作家思想的传统理解，否认二者统一的可能性。中东欧经济转轨国家关于二者结合的实践及理论探索，均以放弃公有制而告终。中国特色社会主义经济改革实践的根本特征，在于坚持二者的有机统一，已经取得了重大进展，同时面临一系列新的问题。

关键词：中国特色社会主义政治经济学 社会主义市场经济 公有制 市场机制 混合所有制

How to effectively integrate the basic economic system of the primary stage of socialism in which public ownership is the dominant and diverse economic sectors develop side by side with a resource allocation model in which the market plays a decisive role is a fundamental issue in building a socialist political economy with Chinese characteristics. Western bourgeois economics and the traditional understanding of Marxist classical writers reject the possibility of such integration. In the transitional countries of Central and Eastern Europe, the practice and theoretical exploration of combining the two ended by abandoning public ownership. The fundamental feature of socialist economic reform practice with Chinese characteristics is to uphold their organic unity. This approach has already achieved great progress but at the same time is confronting a series of new problems.

Keywords: socialist political economy with Chinese characteristics, socialist market economy, public ownership, market mechanism, mixed ownership

In seeking to uphold the movement of reform towards a socialist market economy, the fundamental requirements of releasing and developing the productive forces determine that China must dialectically integrate the basic economic system of the primary stage of socialism, in which public ownership plays the dominant role and different economic sectors develop side by side, with the resource allocation model in which the market mechanism plays a decisive role.

I. Integrating the Market Mechanism and the Basic Economic System in the Primary Stage of Socialism

1. Upholding the reform direction of moving toward a socialist market economy with Chinese characteristics is not only the basic principle to be upheld in China's reform and development, but also a notable question facing the socialist political economy with Chinese characteristics

The heart of the problem is how to integrate the market economy with a basic economic system in which public ownership is dominant and diverse forms of ownership develop side by side. It involves at least two elements: the integration of socialist public ownership with the commodity, currency and market economy, and the coordination of government regulation and market adjustment.

To address the first aspect of the problem, we need to answer at least two questions: how can the diversified ownership structure of the primary stage of socialism be organized in such a way that it satisfies the requirements of the market economy while safeguarding the social nature of the dominance of public ownership (including the state-owned and the collective economy) and the coexistence of different economic sectors and observes the law of value governing commodities, currency, and the market? And how will public ownership itself adapt to the basic requirements of the market economy? If we adhere both to the dominant role of public ownership in the ownership structure and the decisive role of the market economy in resource allocation, then the ownership system and the system of public enterprise property rights itself must comply with the basic requirements of market competition. In particular, we need to determine the status and distribution of public ownership and the means of achieving them, with a view to maintaining order among the players in market competition.

The nature of competitive market transactions is that proprietors exercise independent commodity ownership on the basis of a particular ownership system and obtain economic benefits through voluntary transfer of that ownership. Effective transactions or full competition must satisfy at least two basic conditions in term of ownership or property rights. Firstly, the ownership of the means of production and the corresponding ownership rights must be of a purely economic nature and thus, in the first place, obey the laws of the market economy with no extra-economic coercion (whether administrative, judicial, political or patriarchal), so as to safeguard fair trading in the market. Although private ownership and the division of labor—the two basic prerequisites for the emergence of market transactions, according to Marx—had long existed in pre-capitalist societies, they did not generate any form of market economy, mainly because the extra-economic coercion of judicial and administrative functions arising from “personal dependence” based on the limited natural economy (see below) had become “attributes of landownership.”¹ Secondly, the players must have clear ownership or property rights over the object of the transaction, because transactions, after all, involve the bounded

1 See Karl Marx, *Capital*, vol. 3, pp. 436, 889-897; Karl Marx and Friedrich Engels, *Collected Works of Marx and Engels*, vol. 46, p. 913.

and exclusive transfer of rights. This is the precondition for transfer of commodity ownership in market transactions, which cannot occur unless rights are transferred between right holders. In particular, in the course of trading, transaction margins must define the rights, responsibilities, interests and relationships of different owners in such a way that those engaged in the transaction are constrained by the associated rights and responsibilities and by incentives that correspond to those responsibilities. This enables transactions to be made in an efficient and orderly way. These two basic conditions were first encountered in capitalist private ownership, when the market economy became integrated with Western Europe's basic capitalist system to create, for the first time in history, the capitalist market economy.² Can socialist public ownership meet the basic requirements of the market economy? And if so, how? These unprecedented historical propositions constitute the main problem to be addressed by reform of the socialist market economy and political economy with Chinese characteristics.

The key to the second element, i.e., the government/market relationship, is coordination of the relationship between active government regulation and market competition adjustments. To handle this relationship, the position and functions of the government and the market should be defined, as should the scope, mode and degree of those functions. In fact, the question of the government/market relationship exists not only in socialist economies, but also in contemporary capitalist societies and economies. The particular feature of the handling of this relationship in the socialist economy with Chinese characteristics lies in coordinating government planning and market regulation for the fundamental primary stage in which public ownership plays the dominant role and diverse forms of ownership develop side by side. After all, the organic integration and coordination of government and market regulation is the best long-run approach to operating and implementing China's basic economic system; the problem is not one of regulating the allocation of resources in a general sense. This is the underlying reason for the lasting and profound differences and disputes about the relationship of planning and the market in the exploration of socialist economic theory and practice.

2. The traditional theories of the two types of economic thought have always rejected the idea that socialist public ownership can be integrated with the market economy

One of these negative rejections comes from traditional bourgeois economics. All the major mainstream economic theories, from classical British economics to Marshall's neo-classical economic theory, Keynesianism, the neoclassical synthesis and neoclassical macroeconomics, as well as the earlier physiocracy and mercantilism and today's monetarism and New Keynesianism, reject the possibility of integrating socialist public ownership with market mechanisms. They all see centralized planning as the operational form of public ownership and the competitive market as the operational form of privately owned capital, placing public ownership and the market economy in opposition. Hence they reject the possibility

2 See Li Yining, *The Origins of Capitalism: Comparative Studies of Economic History*.

of obtaining competitive efficiency in a society characterized by public ownership.³ On the other hand, traditional Marxist political economy also rejects the possibility that public ownership and the market economy could be compatible. It holds that private ownership and the division of labor are the necessary historical conditions for commodity production and exchange and that capitalist private ownership of the means of production is the basic institutional foundation for competitive market mechanisms. Due to extra-economic coercion and the undeveloped nature of the division of labor, private ownership in pre-capitalist societies was unable to generate a mode of production based on exchange value. Starting from the people as historical actors, Marx generalized the evolution of human society into three types.⁴ In the communist society, where private ownership and the differences between workers and peasants, town and country, and mental and physical labor have been done away with, market economic relationships cannot exist. In terms of historical value orientation, production is a social activity, but under conditions of commodity production and exchange in the market economy, the social character of production must be realized indirectly through market exchange. Producers have no control over their production; it is determined by alien market forces, resulting in commodity and monetary market fetishism. The development of human society from mutual dependence to dependence on things, and thence to control by things, overturning and distorting subjective/objective relationships. This will create the necessary material conditions for the new society of the future characterized by the all-round development of man. At that time, people's social relations and the social character of production will no longer and should no longer be realized circuitously and indirectly, but rather in a conscious and direct manner.⁵

The economic theory and practice of socialism with Chinese characteristics developed under particular historical conditions. Through the "New Democracy" revolution, China, which had suffered so much for so long, moved directly from a semi-colonial and semi-feudal society into the stage of socialism. The socialist road with Chinese characteristics, especially at its primary stage, could not but have a long course of historical development. It had a long way to go before reaching communism, including the primary stage of communism,

3 In fact, this was also the central issue in the heated and far-reaching debate about the future and fate of socialism between Mises-Hayek and Lange in the 1920s and 1930s. See Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth"; August von Hayek, *Individualism and Economic Order*; Oskar R. Lange, *On the Economic Theory of Socialism*; and W. Brus and K. Laski, *From Marx to the Market: Socialism in Search of an Economic System*.

4 See Yang Xuegong and Lou Junchao, "Understanding Marx's Theory of Three Social Forms: With Reference to Some Views Commonly Held in Academic Circles." The authors point out that the term "social form" in Marx's original works appears as *Gesellschaftsform* in the German edition. The new Chinese edition of the complete works of Marx and Engels translates it as "social form" (社会形式), which differs somewhat from the "social formation" (*Gesellschaftsformation*) of the earlier translation of the complete works.

5 Karl Marx, *Capital*, vol. 1, pp. 87-101; Karl Marx and Friedrich Engels, *Selected Works of Marx and Engels*, vol. 3, p. 10.

as defined in the classic works of Marx and Engels, lacking as it did an objective basis in the forces of production for doing away with commodities, money and markets. But at the same time, China fundamentally rejected private ownership, establishing a basic economic system for the primary stage of socialism in which public ownership played the dominant role and diverse forms of ownership developed side by side. For this reason, the development of market mechanisms was both necessary and possible. There was no need to be mired in specific concepts, like “transition period,” “socialism” or “the first stage of communism”; the important thing is that the CPC theory of the primary stage of socialism has provided the answer to the historical tasks for this stage,⁶ with remarkable success. In the primary stage of socialism, the market must play a decisive role in the allocation of resources, for which purpose an economic structure composed of diverse elements is required: not only the non-public economy but also the dominant public economy must be incorporated as an organic unity into the market economy. On this key issue, however, neither the classical writings of Marx and Engels nor the previous practice of socialism have given a ready answer to the question of how this can be done. This means that we need to carry out creative exploration.

3. Fundamental differences from the initial Soviet socialist system: the relationship between public ownership and the market

Russia’s October Revolution of 1917, led by Lenin, turned the socialist theory of the Marxist classical writers into the practice of institution-building for the first time in the history of mankind. However, from the very beginning, CPSU opinions differed over transforming the common ownership Marx envisaged for the new society of the future into a realistic system, dealing with the relationships between commodities, money and the market, etc. These disagreements were highlighted by the dispute between Lenin and Bukharin. Lenin believed in establishing state-owned monopolies, doing away with the small-scale private economy of peasant households and thereafter eliminating commodity market relationships. Bukharin, on the other hand, was of the view that the Soviet government should weaken state ownership and initiate the historical process of the withering away of the state in accordance with Marx’s theory. He believed that all enterprise powers should be vested in the Soviet and controlled by workers’ councils; the private property rights of the rural peasantry should be preserved and recognized; and the requisite market exchange relationships should be developed in the course of the transition to socialism. In the end, Lenin’s view won out and a socialist system of “military communism” was initiated. It was marked by the whole sale nationalization of urban industry and commerce, the adoption of grain requisitioning in the rural economy (forced requisitioning without compensation); citizens providing their labor for free (wages were eliminated); and abolition of commodity exchange and markets. The result was economic chaos and recession (from June 1918 to March 1921). Lenin had to

⁶ See *Report of the 13th National Congress of the CPC: Firmly March on the Path of Socialism with Chinese Characteristics, and Strive to Complete the Building of a Moderately Prosperous Society in All Respects*, pp. 150-180.

turn to the “New Economic Policy” (NEP). There were two fundamental differences between the NEP and military communism. Firstly, in terms of ownership, unitary state ownership changed to the coexistence and development of a number of forms of ownership along side public ownership. Secondly, in terms of operating mechanisms, certain market adjustments were introduced into the “one big workshop” management style under unified government direction. As a result, a mixed economy took shape, consisting of the peasant household economy, the small commodity economy, private capitalism, state capitalism, state ownership, etc. The self-adjusting role of the market was partially recognized in that grain requisitioning was replaced by grain levies; peasants were permitted to sell their surplus produce on the market once they had paid the grain levy; private enterprises were allowed to open and to engage in market competition; capitalists could contract to manage state-owned enterprises (SOEs); foreign capital was allowed to enter the country; and SOEs were required to maintain independent accounting and operate on the basis of market demand.⁷ When the “strategic retreat” represented by the NEP came to an end with economic recovery and Lenin’s death, the Soviet Union once again faced the basic question of what type of socialism to establish. There were serious divisions within the CPSU, especially between Stalin and Bukharin. Bukharin advocated the long-term continuance of the NEP, insisting on diverse forms of ownership and market adjustment (NEP practice had changed his views on the system to be established after the seizure of political power).⁸ He believed that Lenin’s NEP, aiming to restore market relations structured on diverse types of ownership including state ownership, private capitalist ownership, private ownership of small businesses, etc., should be a long-term rather than a one-off program.⁹ By contrast, Stalin held that a centrally planned economy should be established on the basis of public ownership, especially state-owned monopolies. The debate ended with the establishment of the “Stalinist model,”¹⁰ under which urban industry and commerce were under state ownership and control, the rural economy was collectivized, and market regulation of production was eliminated. This produced a centrally planned economy in which public ownership was seen as fundamentally opposed to market mechanisms.¹¹

4. *In terms of reform practice and theoretical exploration, the real issue is the integration of public ownership and market mechanisms*

7 See Liu Wei and Ping Xinqiao, *Three Theories on Economic Reform: Property Rights Theory, Market Theory, and Equilibrium Theory*; Peng Jinqing and Peng Dacheng, “From ‘Military Communism’ to the ‘New Economic Policy’: The Great Change in Lenin’s Socialist Exploration.”

8 Bukharin criticized the Soviet economist Yevgeni Preobrazhensky’s theory of primitive socialist accumulation, under which heavy industry in under developed countries was to be financed through extra-economic coercion. This, in essence, was a continuation of the “military communism” policy. See Yevgeni Preobrazhensky, *New Economics*.

9 Nikolai Bukharin, *Selected Works of Bukharin*, vol. 1, p. 441.

10 The “Stalinist model” of the centrally planned economy stresses that at the initial stage, underdeveloped socialist countries should give priority to heavy industry to ward off encirclement and invasion by the imperialist powers. This helped the Soviet Union win a great victory in the war against fascism, but also created the series of problems described in this article.

11 See Joseph Stalin, *Economic Problems of Socialism in the USSR*.

From 1950, Yugoslavia began to abandon the centrally planned economy's traditional state ownership and replace it with what was termed "social ownership" in an effort to integrate the new public ownership with market mechanisms. However, since there were no ownership rights under social ownership and distortions in enterprise behavior impeded their acceptance of hard market constraints, the macroeconomy that grew up on the basis of microeconomic changes remained extremely unbalanced and structural rigid for a long time; hence the integration of public ownership with the market was not effective.¹²

Hungary's "quiet revolution" in 1956 was also intended to introduce market mechanisms to public ownership. While maintaining the dominant position of state ownership, it allowed individually owned small businesses and farms and implemented democratic management in state-owned industrial and commercial enterprises, granting them certain independent decision-making powers. However, as long as traditional state ownership held a monopoly position, it was hard to meet the basic requirements of market mechanisms. Not long after, Hungary returned to the traditional Stalinist model.

Similarly, the Polish economy, established in accordance with the Stalinist model in the early postwar period, began reformist attempts to incorporate market mechanisms into public ownership in the mid-1950s. According to Lange, while upholding the state-owned system, the government was to encourage enterprises to adopt independent accounting systems and dispersed decision-making and balance their budgets through market competition, with a view to obtaining efficient competitive markets under a public ownership system. In practice, however, there were major conflicts between the basic system of traditional state ownership and enterprises' balancing of their own budgets through the market.¹³

In the post-war period, Czechoslovakia too applied the Stalinist model until the late 1950s, when it started to explore reform. While upholding state ownership, Czechoslovakia highlighted the autonomy of worker's councils and attempted to introduce competitive price mechanisms on an institutional basis. A true price mechanism was, however, impossible under traditional state ownership, because the emphasis on worker's council autonomy ran counter to the essential character of such ownership, making efficient and orderly operation virtually impossible in practice. The particular international and domestic context after the 1960s saw an end to the exploration of integrating public ownership with the market.

Starting in the mid-1960s, the Soviet Union tried to reform the Stalinist model through decentralization (the Kosygin reform). It gave enterprises greater autonomy, reformed the price mechanism, checked and incentivized enterprises with market price signals, and improved inter-enterprise competitiveness, with a view to achieving competitive efficiency without altering traditional state ownership. However, this ceased at the end of the 1960s because there was no agreement on theory and no institutional safeguards in practice. At the

12 Edvard Kardelj, *Contradictions of Public Ownership in Contemporary Socialist Practice*; Benjamin Ward, "The Firm in Illyria: Market Syndicalism," pp. 566-589.

13 See Oskar Ryszard Lange, "Simulation Market: The First Sketch of the New Model," pp. 12-29.

same time, Lieberman and others put forward the associated reform approach of “market socialism,” seeking to provide theories and policies that explained the viability and necessity of introducing market mechanisms on the basis of public ownership. However, with the end of the exploration of reform practice, the theory of market socialism met with sustained criticism which only ceased in the mid-1980s.¹⁴

The effective integration of socialist public ownership with market mechanisms was clearly an unresolved problem for both theory and practice. In the 1980s, the economic transition of Central and Eastern Europe entered a new period of fundamental reform. In order to establish a market economy, they abandoned the basic economic system of public ownership and returned to the traditional rejection of the possibility of combining public ownership and market mechanisms. As a result, privatization and marketization became the basic logic of reform. As the Washington Consensus put it, the overall logic of reform accorded with the paradigm of macroeconomic stabilization, privatization and marketization. Although Western scholars’ analysis of historical and systemic evolution or general equilibrium varied greatly, their differences were confined to the methods and paths by which economic transition would supplement the Washington Consensus and the New Washington Consensus or to examining the Post-Washington Consensus. They all held the same view of the goals of transition, taking the privatization of capital as the institutional premise, the market as the orientation and liberalization as the criterion.¹⁵

II. China’s Creative Reform Exploration and Contribution to the Integration of Public Ownership with the Market Economy

1. Using basic Marxist methodology to analyze the practice of reform in integrating public ownership with the market economy

The neoclassical price theory of Western mainstream economics explains economic transition in terms of general equilibrium. Its value orientation is basically premised on privatization, but its theoretical analysis overlooks the proposition of ownership reform and reform of enterprise property rights. The mainstream of China’s economic reform upholds basic Marxist theory and methods, applying them in particular to reforms involving the integration of public ownership with the market economy. It is expressed in concentrated form in the following features. First, in explaining the historical inevitability of reform, China starts from the theory of historical materialism’s contradiction between the productive forces and the relations of production. It sums up the self-improvement and development of the socialist system and its relations of production as constituting the essence of reform and the release and

14 See Xing Guangcheng, “Lieberman and the ‘Lieberman Proposal.’”

15 See Jan Kregel, Li Lili and Li Jiajia, “The Discrete Charm of the Washington Consensus”; Joseph Stiglitz, “The Post-Washington Consensus Consensus”; Grzegorz W. Kolodko, *From Shock to Therapy: The Political Economy of Postsocialist Transformation*; Mao Zengyu, “Stiglitz’s Critique of the ‘Washington Consensus.’”

development of the productive forces as providing the impetus for reform. The basic criterion for evaluating the performance of reform remains the issue of whether the productive forces are protected, released and developed. The second feature is that China starts by understanding the nature of and changes in the relations of production, grasping reform in the sense of changes in the relations of production and seeing the nature and real difficulties of reform as involving changes in the ownership structure and the manner in which it is realized. In particular, this approach stresses the diversification of ownership structure and the importance of the reform of SOEs. Third, in understanding the overall reform model, China has always interpreted the historical connotations of reform in two respects, that is, the basic economic system and the operational resource allocation mechanisms underlying the ownership structure. It emphasizes the inherent coordination of the two, that is, the relationship between the reform of enterprise ownership and the development of the price mechanism.¹⁶

2. Promoting China's transformation into a socialist market economy through the unity of ownership structural reform and the development of market mechanisms

Reform oriented towards a socialist market economy covers two basic propositions. On one hand, it involves ownership reform, including ownership structural reform and enterprise property rights; on the other, it involves reform of resource allocation mechanisms, including marketization and government reform. China's reform and opening up have advanced by unifying these two propositions: the country does not simply focus on marketization at the expense of reform of ownership and enterprise property rights, but nor does it blindly promote reform of ownership and enterprise property rights without taking into account the requirements of market mechanisms.

In 1982, the 12th CPC National Congress acknowledged for the first time that individually owned businesses were a useful complement to the socialist public economy (a position enshrined in the Constitution amended by the 5th Session of the 5th National People's Congress in December of the same year); accordingly, it proposed the leading role of the planned economy and the supplementary role of market regulation for the first time. In 1986, the 6th Plenary Session of the 12th CPC Central Committee made it clear that China would develop a variety of economic elements premised on the dominant role of public ownership. For the first time, the Party recognized that the existence and development of the private economy constituted a necessary and desirable supplement to the socialist public economy (a position was later introduced into the Constitution amended by the 1st Session of the 7th National People's Congress in 1988). In 1987, the 13th CPC National Congress emphasized that the socialist economy was a planned commodity economy in which government planning was integrated with market regulation. Planning and the market were seen as parallel mechanisms covering the whole of society (leaving aside the question of which was the main player and which was supplementary). This was a big step forward compared to the

16 See Li Yining, *Imbalances in the Chinese Economy*; Wu Jinglian and Liu Jirui, *On the Competitive Market System*.

acknowledgment by the 12th CPC National Congress that individually owned businesses were a useful complement to the dominant socialist public economy. In 1992, the 14th National Congress of the CPC made it clear for the first time that the non-public economy was an important part of China's socialist national economy and that the various economic sectors would develop together for a long time to come, with public ownership playing the dominant role supplemented by individually owned businesses, private businesses and foreign-owned enterprises. Different economic sectors could form mixed ownership entities at will. Accordingly, with regard to the mode of resource allocation, the establishment of a socialist market economy was explicitly stated as the goal of the China's socialist economic reform for the first time (a position written into the Constitution amended by the 1st Session of the 8th National People's Congress in 1993). This was the first time that socialism and the market economy had been considered as an integrated and unified whole. In 1997, the 15th National Congress of the CPC further made it explicit that a system "in which socialist public ownership is dominant and diverse forms of ownership develop side by side" was the basic economic system for the whole of the primary stage of socialism (a position introduced into the Constitution amended by the 2nd Session of the 9th National People's Congress in 1999), and that the fundamental task of economic reform was to unite the basic economic system with the market economy. In 2002, the 16th National Congress of the CPC explicitly stated for the first time that China would "unwaveringly consolidate and develop the public sector of the economy and unswervingly encourage, support and guide the development of the non-public sector." In 2004, the 2nd Session of the 10th National People's Congress amended the Constitution to make it clear for the first time that private ownership of the means of production (not only consumer goods) was as inviolable as public owned resources. In 2007, the Fifth Session of the 10th National People's Congress adopted the PRC Property Law, which further specified the protection of private property enshrined in the Constitution. This Session decided to further develop socialist market mechanisms. The 3rd Plenary Session of the 18th CPC Central Committee in 2013 made the decision to comprehensively deepen socialist market economic reform, a move similar to that made nearly 30 years before when the 3rd Plenary Session of the 12th CPC Central Committee made the decision to carry out economic reform in the autumn of 1984. In the Decision of the Central Committee of the Communist Party of China on Some Major Issues concerning Comprehensively Deepening the Reform, China reaffirmed that it would persist with a basic economic system in which public ownership played the dominant role and different economic sectors developed side by side while stressing the importance of developing a mixed economy involving different types of ownership. Accordingly, as regards the mode of resource allocation, the Decision proposed the in-depth development of socialist market economy mechanisms and emphasized the correct handling of the relationship between government and market to enable the market to play a decisive role in resource allocation and government to utilize its role to the full. In short, taking reform of the ownership structure and development of market mechanisms

as integrated and complementary propositions is not only an internal requirement of the contradictory movement of the productive relations and productive forces, but also the basic logic of China's reform practice.

3. Developing the internal competition mechanisms of the socialist market economy while integrating reform of enterprise property rights and price formation

The internal competition mechanisms (or an internal competitive order) of a market economy have two aspects. The first is order among market players, or the rules that define who can enter the market and participate in competition. At the heart of this system are enterprise property rights, which answer the question of who is competing. The second is the market economy's trading order, or the rules that specify trading conditions. At the heart of this system is price formation, which answers the question of how competition should be carried out. The institutional arrangements of "Who competes—enterprise property rights," and "How is competition to be carried out—price formation," lie at the heart of the market economy's internal competition mechanisms. At the beginning of its transition, China, with its tradition of a planned economy, had neither a modern enterprise system capable of adapting to the requirements of the market economy nor competitive trading mechanisms. Because of the historical particularity of this starting point, the transition from a planned to a market economy had to develop both enterprise property rights (or order among players) and a price formation system (or trading order) at the same time, resulting in the special question of how to coordinate the reform of the two systems.

In fact, given the absence of a modern enterprise system and a competitive pricing system, economic transition could only be carried out by reforming both systems. The reform of enterprise property rights is the institutional basis for pricing reform; the latter cannot be realized without the former. After all, it is the players engaged in trading who decide the terms of trade; in other words, the order among players determines the trading order. At the same time, price determination is a moving form of enterprise property rights. In the absence of a competitive market pricing mechanism, there is no way for market movement to realize enterprise property rights or behavior. Under market conditions, exchange is the basic way for enterprise property rights to realize the enterprise's economic interests, and the exchange mechanism is the premise for realizing a modern enterprise property rights system.

4. Promoting the integration of public ownership and market mechanisms while bearing in mind the unity of the urgent need to release and develop the productive forces and the feasibility of economic reform

Firstly, in the dual economy, comprehensive economic reform spread from the rural to the urban economy. The fact that economic reform in rural China, especially in the household responsibility system, took the lead in making a breakthrough, was fundamentally due to the economic backwardness of rural China. The traditional planned economy and the longstanding strategy of prioritizing the development of heavy industry at the expense of agriculture had a destructive effect on the rural economy, subjecting it to severe constraints. This disturbed the

equilibrium of the whole national economy; the productivity of agricultural labor was extremely low and more than 70 percent of the labor force (the figure for the world's poor countries) worked in agriculture. The basic needs of rural dwellers went unmet for a long time. This lent urgency to the demand for developing and releasing the productive forces in the countryside and strengthened the demand for reforming traditional production relations.

Secondly, on the choice of whether enterprise or government reform should be prioritized, the focus shifted from enterprise reform to government reform. How to deal with the relationship between government and the market has become a major issue. Though China's planned economic system was largely a copy of the Stalinist model, there were important differences. The Stalinist model gave greater emphasis to central planning; local governments had little room to maneuver, and were controlled from the top down. On the other hand, in China's planned economy, even though control was centralized, local governments had more room to move in a system that allowed for both horizontal and vertical administration. Prior to reform and opening up, institutional restructuring focused on vertical/horizontal contradictions, i.e., the relationship between the central and local governments; enterprises were never involved. The last 30 years of reform and opening up, however, made it clear from the start that the focus would be on (state-owned) enterprises; this change of target led to fundamental progress in both depth and breadth. The historical process of fostering the development of a socialist market economy was, in a sense, a process of transforming the relationships between enterprises, the market and the government. This was primarily founded on enterprise reform, especially on the issue of establishing a modern enterprise management system that could adapt to the basic requirements of the market economy. Alongside the progress and requirements of enterprise reform, China endeavored to foster a robust market system and market order. Together with the horizontal enterprise connections thus produced in the market economy, this resulted in the gradual development and improvement of the efficient competitive market mechanisms needed for social reproduction. As the transformation of enterprise management and the pricing system progressed, the associated government transformation and reform increasingly become the main aspect of the contradiction. The more thorough going the reform of the enterprise and market system, the more urgent and profound was the demand for the transformation of government functions and reform of government institutions. This was an inherent requirement of institutional change and the historical logic of China's transition to a socialist market economy.

Thirdly, in the course of enterprise reform, the focus of the main measures shifted from reform of income distribution to reform of enterprise property rights. Although, generally speaking, enterprise property rights involve all aspects of the bundle of enterprise rights, in the strict sense we must distinguish between distribution rights and the exclusive possession that characterizes enterprise property rights. China's urban economic reform started with the reform of SOEs, but in contrast to rural economic reform, it focused for some time on distribution rather than the ownership system and the enterprise property structure. The rural household

responsibility system involved reform of property rights to a basic means of production—agricultural land—rather than a general change to distribution relationships. Urban enterprise reform differed in that it revolved for a long time around the income distribution relations between the government, enterprises and workers. For example, enterprises were initially allowed to retain profits; the surrendering of profits was then replaced by the payment of taxes; thence there was a shift to the contract management responsibility system. All these measures represented adjustments to distribution relationships. In 1992, the 14th National Congress of the CPC set the goal of reforming the socialist market economy, and in particular, the 3rd Plenary Session of the 14th CPC Central Committee proposed the historic task of establishing a modern enterprise management system suited to the socialist market economy. Since then, following the basic idea of “invigorating large enterprises while relaxing control over small ones,” the emphasis of SOE reform has shifted from adjusting the distribution of general interest relationships, especially those between enterprise income and government revenue goals, to the reform of enterprise ownership and property rights structures.

III. Reform of SOEs in a Mixed Economy

Reforming SOEs in such a way that they can meet the basic requirements of market competition without losing their public ownership status is a key problem in integrating socialist public ownership with the market economy.¹⁷

1. Developmental goals of mixed ownership economic entities

First of all, we must clarify the goal of mixed ownership economic reform of SOEs. Failure to do so would leave reform blind, unable to choose a suitable scope and process. All the changes in the relations of production were fundamentally aimed at meeting the requirements for the development of the productive forces. Since all of society was operating under a mixed economy in which public ownership played the dominant role and various types of ownership developed side by side, their fundamental aim was to release and develop the productive forces for the present stage of China’s development. At the same time, mixed ownership reform at the level of individual SOEs was designed to enhance their competitiveness, efficiency, innovation and capacity for development. Only those SOEs that can adapt to or need to pursue this new goal should come under mixed ownership reform.

In the strict sense, the development goal of SOEs is to maximize the national welfare. In general, if we take the maximization of market profits as the criterion, the micro-level efficiency of SOEs is clearly lower than that of non-SOEs. Ordinary market profit is not the

17 Mixed ownership enterprise reform was initially put forward in the report to the 13th CPC National People’s Congress and elaborated in the reports from the 14th to the 18th National Party Congresses. In particular, the Decision of the Central Committee of the Communist Party of China on Some Major Issues concerning Comprehensively Deepening the Reform, adopted at the 3rd Plenary Session of the 18th CPC Central Committee provided a systematic explanation of the importance, urgency, implementation path and basic methods for developing mixed ownership economic entities.

primary purpose of SOEs; rather, they are set up in the overall national interest to pursue the broader goals of social and macro-economic development. Therefore, we cannot simply say that SOEs are necessarily inefficient without considering what the criterion for efficiency is. In addition, the particular characteristics of some fields (or some historical periods) determine that they provide a poor return on investment and are less profitable as a whole, resulting in a general reluctance on the part of private capital to enter these areas. However, the cultivation of such areas is needed for the long-term development of society and for overall strategic national goals, which makes SOEs an indispensable choice. In such situations, their low profitability is objectively reasonable. In other words, it is precisely because of the “naturally” low competitive efficiency of these fields that SOEs step in and assume social development responsibilities. Therefore, we need to be clear about whether the overall low efficiency of SOEs (if judged by the micro-level criterion of competitive market efficiency) is caused by the poor “natural” profitability of these fields or is simply because the SOE’s entry into this field (or into a particular economic area) has led to lower enterprise efficiency. In short, SOE efficiency cannot be measured simply by the micro-level indicator of market competitiveness.

Here an important question arises: how does mixed ownership reform make a choice between monopolies and competition? In principle, mixed ownership reform can be carried out in areas of a competitive or non-natural monopoly nature, irrespective of the size of the enterprise itself, as long as the field is a competitive one. In such cases, one can consider denationalizing SOEs and changing them into mixed ownership entities.

2. Institutional objectives of mixed ownership reform

The institutional objectives of mixed ownership SOE reform should be consistent with the development objectives. Unlike those of the traditional SOEs, such objectives aim to improve market competitiveness so as to maximize the competitive revenue. Therefore, systemic reform objectives need to enable enterprises to meet the basic requirements of and satisfy market competition rules in terms of institutions and mechanisms. This applies to the basic requirements of enterprise management, especially enterprise ownership.

In the management structure of ex-SOE mixed ownership entities, the following principles should be observed for legal and property rights systems. They comprise voluntary combination among the owners of different factors and different owners’ equal rights, unrestricted exit, symmetrical information and fair distribution of interests. If these principles are not observed, the corresponding powers of enterprise ownership will disintegrate under mixed ownership, and a lack of balance in the enterprise property rights’ management structure will not only jeopardize the efficiency brought about by the institutional division of labor in property rights but also lead to grave violations. As Marx said in his analysis of the capitalist shareholding system, the system’s biggest problem was that it allowed some people to risk the assets of others or of society without bearing any responsibility.¹⁸

18 Karl Marx and Frederick Engels, *Collected Works of Marx and Engels*, vol. 46, p. 198.

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